VZCZCXRO1799
PP RUEHCD RUEHGD RUEHHO RUEHNG RUEHNL RUEHRD RUEHRS RUEHTM
DE RUEHMC #0280/01 1700138
ZNR UUUUU ZZH
P 180138Z JUN 08
FM AMCONSUL MONTERREY
TO RUEHC/SECSTATE WASHDC PRIORITY 2981
INFO RUEHME/AMEMBASSY MEXICO PRIORITY 3955
RUEHXC/ALL US CONSULATES IN MEXICO COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEHMC/AMCONSUL MONTERREY 8440

UNCLAS SECTION 01 OF 02 MONTERREY 000280

SENSITIVE

SIPDIS

STATE PASS TO USTR AND FCS

E.O. 12958: N/A
TAGS: ECON EIND ETRD PGOV MX
SUBJECT: US ECONOMIC SLOWDOWN WILL IMPACT MEXICO AS INFLATION FEARS LOOM

REF: A) MEXICO 240; B) MEXICO 1504

MONTERREY 00000280 001.2 OF 002

¶1. (SBU) Summary. On June 13, at the Consulate's periodic Business Roundtable, two leading economists presented their views of the impact of the United States economic slowdown on Mexico and Mexico's growing inflationary concerns. The event, hosted by the Consul General, brought together fifteen of the Consulate's best private sector contacts. The economists agreed that Mexico has not yet experienced the full impact of the U.S. economic slowdown, which will most strongly affect Northern Mexico. Although Mexican inflation is still very low by historical standards, prices are increasing above the Central Bank's target and inflationary expectations are also rising, which may require increasing Mexican interest rates. Finally, the economists and our private sector contacts decried President Calderon's suggestion that the Mexican Central Bank reduce interest rates to spur economic growth. End Summary.

¶2. (SBU) The two economists who made presentations were Dr. Agustin del Rio Toffe, regional head of the Mexican Central Bank (who emphasized that these were his personal views) and prominent local economist Dr. Salvador Kalifa.

¶3. (SBU) Both economists agreed that the slowdown in the United States would have a significant impact on Mexico, particularly the Northern region. Kalifa described the collapse of the subprime mortgage market and subsequent decline in the U.S. housing market, and he estimated that nine million U.S. homeowners are underwater, i.e. their homes are worth less than their mortgages. The declining housing market means fewer construction jobs for Mexican legal and illegal immigrants, contributing to the sudden decline in remittances sent by workers in their United States to their Mexican relatives. Kalifa thought that there would be a lag of at least 3-4 months before other effects of the American economic slowdown hit Mexico. Del Rio described the "wealth effect," that since home ownership is the most important asset for most Americans, when the value of their house declines, they will spend less money on consumer goods. The wealth effect will have its strongest impact in Northern Mexico, which is very dependent on exporting heavy consumer goods to the United States such as cars, domestic appliances or electronics. Nonetheless, the negative trend could be partially offset as American auto manufacturers reduce costs by moving production to Mexico. However, historically there is a strong correlation between the U.S. industrial production and Mexican economic growth, so U.S. economic problems will eventually hit Mexico. Kalifa forecast that the Mexican economy would begin to stumble in the first half of
¶2008. However, he allowed that Mexico was in far better shape

than before. Although the foreign trade deficit is high, Mexico has ample foreign reserves and much of its foreign debt is denominated in pesos. After the discussion period following the presentations, several business leaders agreed that Mexican exports would be hit hard by reduced U.S. demand (see reftel A).

¶4. (SBU) Kalifa and Del Rio also thought that Mexico faces serious inflationary pressures due to rising energy and food prices. Although low by Mexican historical standards, the approximately 4.5-5% inflation rate is the highest in six years, and del Rio conceded that inflation would remain above the Central Bank's target of 3% for 2008. Kalifa thought that the Mexican Central Bank would increase interest rates, perhaps as soon as its June meeting, to counter rising expectations of inflation. Del Rio prudently did not make a prediction on future interest rates, but he did comment that inflation was a serious concern. Unlike the Federal Reserve Bank, which has the twin goals of maintaining price stability and fostering economic growth, the Mexican Central Bank's sole mission is to contain inflation. Del Rio said that if there are rising inflationary expectations (such as pressure from unions for higher salaries in anticipation of future inflation), the Central Bank could counter with increased interest rates to dampen demand (see also reftel B).

¶5. (SBU) Finally, the economists and businessmen took President Calderon to task for publicly calling for the Mexican Central Bank to reduce interest rates to stimulate the economy. Del Rio's personal opinion was that President Calderon should not have made the suggestion, as it undermined the Central Bank's credibility for fighting inflation. Del Rio commented that with current inflationary pressures from increasing food and energy prices, any reduction in interest rates would increase inflation. Kalifa also noted that the Government of Mexico was stimulating demand through spending and he thought that there would be a clash between President Calderon and the Central Bank on interest rates. Several businessmen thought

that the independence of the Mexican Central Bank was critical for investor confidence and that Mexico would control inflation. They criticized President Calderon for trying to undercut the autonomy of the Mexican Central Bank.

¶6. (SBU) Comment. There may well be a clash between the needs of the Mexican economy and the political calendar. The mid term 2009 elections are crucial for President Calderon to strengthen his ability to pass reforms though Congress, and his political task will be much harder if the Mexican economy grows slowly over the next year. End comment.
WILLIAMSON